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TOPMARKCAPITAL.COM
416 13th St.
2nd Floor
San Diego, CA 92101

While traditional value investing strategies have evolved over time, a new approach centered on assessing leadership quality offers potential for generating long term excess returns. This essay explores how investors can leverage a structured framework to evaluate leadership in today's dynamic market environment.

Evolution of Value Investing

Benjamin Graham and David Dodd were pioneers in finding undervalued assets. One of their simple methods, called "net-nets," involved seeking companies trading for less than their current assets minus all liabilities. As Graham put it, it was like buying dollar bills for fifty cents.

Over time, this strategy lost its edge. Markets became more efficient, ironing out obvious mispricings. Better corporate governance pushed management to maximize asset value. The simple bargains disappeared.

Warren Buffett is a unique value investor. He began in the 1950s, using Graham and Dodd's methods like net-nets described above. But as these strategies dwindled, Buffett evolved his approach. Most investors can't move past what once worked. But with Charlie Munger's help, Buffett shifted to buying "wonderful companies at fair prices." They evolved value investing.

These changes highlight a broader shift in thinking about value creation and capital allocation today. To generate superior returns, investors must grasp the drivers of long-term value and discard old methods when they no longer work.

While Buffett's reputation as the greatest investor alive today is well deserved, it would be foolish to ignore the massive tailwind and driver of value that benefitted his career: the advancement of the quality of management.

Importance of Management Quality

When Buffett first got started, the principal-agent problem was not well understood. The principal-agent problem occurs when managers (agents) may not act in the best interests of owners (principals). This lack of alignment between managers and owners was one of the primary reasons net-nets and other early value investing strategies were so prevalent. In the years that followed, the most important strategies for addressing the principal-agent problem were figured out.

In 1957, Fairchild Semiconductor addressed this issue, igniting an industry. Arthur Rock structured financing to give managers equity ownership. This aligned their interests with shareholders and marked a shift from the salary-based compensation models. This approach ignited the venture capital industry, proving, empirically, that aligned incentives foster innovation and value creation.

In the 1970s, Michael Jensen and William Meckling provided the academic backbone by analyzing conflicts between owners and managers. Their 1976 paper on agency theory is the most cited academic business paper of all time. It showed that equity ownership could transform management behavior. Their premise was simple: align financial incentives to reduce agency costs.¹ This led to widespread use of stock options and performance-based pay in the 1980s and 1990s.² This has been the single largest tailwind to the last 50 years of investment return.

Corporate scandals like Enron and WorldCom in the early 2000s exposed the limits of financial incentives alone. Even with aligned interests, ethical breaches occurred. Jensen

¹ Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, July 1, 1976), <https://doi.org/10.2139/ssrn.94043>.

² Bartley J. Madden and Douglas E. Stevens, "Michael Jensen's Contributions to the Theory of the Firm: A Tribute in Three Acts," *Journal of Applied Corporate Finance* n/a, no. n/a, accessed November 4, 2024, <https://doi.org/10.1111/jacf.12620>.

acknowledged his original work was incomplete. There was more to uncover in corporate governance. Again, we turn to Silicon Valley for empirical solutions to the shortcomings of traditional management models.

Silicon Valley's Founder Mode

In the mid-2000s, Silicon Valley introduced a new approach. Paul Graham, who co-founded Viaweb (later sold to Yahoo), noticed that many smart programmers wanted to start companies but lacked seed money. This led him to co-found Y Combinator, a venture capital firm providing small amounts of funding for small equity stakes. They invested in batches, scaling through standardized deals, group education, and targeted mentorship.

Y Combinator gained a reputation as "founder friendly" - encouraging founders to run their businesses as they see fit with very little oversight. Graham, and his most successful proteges would tell you the results have been incredible. Graham's recent essay, "Founder Mode," attempts to capture the cumulative insights Y Combinator has acquired over the years when it comes to startups: scaling a startup doesn't require adopting traditional management practices, or "Manager Mode." Evidence suggests that such shifts often lead to poor results. Reading between the lines, it is easy to conclude that management practices espoused in the top business schools may be great for managing existing assets, but they are woefully lacking when it comes to new business and technology models.³

Brian Chesky's experience at Airbnb illustrates this point. As the company grew, he adopted Manager Mode, following advice to "hire good people and give them room to do their jobs." Performance suffered dramatically. Only by returning to a hands-on, founder-driven approach—"Founder Mode"—partly inspired by Steve Jobs at Apple, did Airbnb regain its footing.

³ Paul Graham, "Founder Mode," September 2024, <https://paulgraham.com/foundermode.html>.

However, Graham's essay offers few concrete examples of what "Founder Mode" entails in practice, beyond mentioning "skip-level" meetings and Jobs's annual retreats with his top employees. This vagueness makes it hard for other leaders to implement or for investors to evaluate.

These limitations highlight a deeper need: a comprehensive framework for understanding effective leadership within dynamic environments. While Silicon Valley's rejection of conventional wisdom is telling, we need more than anecdotes to generate actionable insights for investors and managers alike.

Our search turns back to academia, revisiting Jensen's work on leadership. We will find his work resulted in solutions that address both his initial concerns about financial scandals and ethical breaches as well as leading dynamic businesses.

Jensen's Leadership Framework

Jensen distinguishes management from leadership in the same way that Paul Graham distinguishes manager mode from founder mode.

Management : Manager Mode

as

Leadership : Founder Mode

Management optimizes within known limits. Leadership ventures into the unknown to create new possibilities. Jensen's leadership framework shows that corporate governance needs more than aligned incentives. It demands understanding leadership, integrity, and organizational behavior.⁴ This shift recognizes the complexity of human motivation.

Defining Leadership

Jensen's definitions are complex. Let's clarify.

- **Leadership:** Using language (spoken, written and action) to create a future that wouldn't happen otherwise.
- **Leadership Situation:** When current conditions and potential futures are unacceptable.
- **Leader:** Someone who shapes circumstances so their actions naturally lead to effective leadership.

Jensen views leadership through outcomes and situations, not specific traits. This departs from conventional management theory and aligns with Graham's observations about traditional approaches' limitations. For Jensen, **leadership is about realizing futures that wouldn't happen otherwise.** It goes beyond optimization. Leaders must:

- Operate effectively amid uncertainty.
- Decide without complete information.
- Take principled stands against opposition.
- Create possibilities others can't see.

⁴ Werner Erhard, Michael C. Jensen (Deceased), and Kari L. Granger, "Creating Leaders: An Ontological/Phenomenological Model," SSRN Scholarly Paper (Rochester, NY: Social Science Research Network, May 10, 2013), <https://papers.ssrn.com/abstract=1681682>.

Jensen's Four Fundamental Leadership Factors

Effective leadership rests on four key factors, especially evident in successful founders.

Integrity

"Somebody once said that in looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if you don't have the first, the other two will kill you. You think about it, it's true. If you hire somebody without [integrity], you really want them to be dumb and lazy."

- Warren Buffett

Integrity is the foundation. It means honoring one's word, building trust and workability. This aligns with Graham's observations of founders like Brian Chesky, who stay involved and follow through on commitments.

Authenticity

"To me, business isn't about wearing suits or pleasing stockholders. It's about being true to yourself, your ideas, and focusing on the essentials"

- Richard Branson

Authenticity is aligning words and actions. It's being truthful about strengths and limitations. Successful founders break from convention when it doesn't fit their genuine assessment. Authentic leaders admit their flaws. This removes pretense and enhances performance.

Commitment Beyond Self

"To make a contribution to the world by making tools for the mind that advance humankind."

- Apple Computer Mission Statement (1980s)

This factor is best explained as dedication to something bigger than personal success. Founders like Steve Jobs stayed engaged beyond what conventional wisdom suggests. Their commitment to transformative futures provided motivation and resilience. This creates "serene passion"—a sustainable drive powering long-term leadership.

Being Cause in the Matter

"Responsibility equals accountability, accountability equals ownership, and a sense of ownership is the most powerful thing a team or organization can have."

- Pat Summit (basketball coach)

Being cause in the matter means seeing oneself as responsible for everything—not as blame but as enabling effective action. Managers with this stance find creative solutions by getting more involved when things go wrong instead of delegating.

This light summary of Jensen's leadership factors highlights the uncanny similarities to Paul Graham's Founder Mode. These factors create a framework, not restricted to founders, that can be taught and assessed, enabling traditional managers to become effective leaders.

Conclusion

Buffett initially found value in net-nets, these companies were so poorly managed that the market frequently valued them below liquidation value. As management quality improved, Buffett pivoted from investing in "fair companies at wonderful prices" to "wonderful companies at fair prices", riding the wave a step further.

Like him, we must seek new sources of value. If the prior wave was driven by broad based improvements in management quality, then the next wave may come from broad based improvements in leadership quality.

Jensen's leadership framework gives us tools to assess leadership quality. Yet these attributes, while necessary, aren't sufficient alone. Effective leadership also needs the right context, resources, and strategies. Further research is needed before we can draw solid conclusions on the topic.

In the appendix, you'll find an analysis of Jensen's four fundamental factors at Intel and SpaceX. These companies show a clear contrast in foundational leadership principles.

Elon Musk's leadership at SpaceX exemplifies Jensen's factors in action. His approach diverges from traditional management approaches. His ability to set audacious goals and achieve them is unparalleled.

In contrast, Intel's decline from an innovation powerhouse to a struggling semiconductor company shows how leadership can go wrong. This decline highlights the critical difference between "Founder Mode" and "Manager Mode" and the consequences of abandoning Jensen's principles.

For investors, the implication is profound. Sometimes, an opportunity emerges that changes how we uncover value. Leadership assessments might be that opportunity. We'd be foolish not to keep pulling this thread.

	SpaceX	Intel
Integrity	<p>At SpaceX, Musk's integrity is demonstrated through his consistent delivery on seemingly impossible commitments. When he declared SpaceX would develop reusable rockets - something the aerospace industry deemed unfeasible - he honored that commitment through years of expensive failures until achieving successful landings. This built unprecedented credibility in an industry historically dominated by traditional aerospace companies.</p> <p>This is reinforced through the company's commitment to transparency about both successes and failures. SpaceX openly shares videos and data, treating setbacks as learning opportunities rather than embarrassments.</p>	<p>Intel's departure from its commitment to technological leadership manifested first through a breakdown in integrity. The company repeatedly missed production milestones and technological targets, particularly in advancing to new semiconductor manufacturing nodes. This wasn't merely a technical failure - it represented a deeper fracture in the organization's relationship with its word. The company's integrity issues became evident in:</p> <ul style="list-style-type: none"> • Repeated delays in delivering 10nm and 7nm manufacturing processes • Inconsistent messaging about technological capabilities • Growing gap between public commitments and actual delivery
Authenticity	<p>Musk's authenticity manifests in his unorthodox, hands-on leadership approach. He regularly works on the factory floor, makes major announcements via Twitter, and openly acknowledges both his strengths and limitations. His communication style, while sometimes controversial, reflects genuine conviction rather than careful corporate messaging.</p> <p>This authenticity extends to publicly acknowledging mistakes and failures. When early SpaceX launches failed, Musk directly addressed concerns rather than attempting to minimize them. This transparency, while unconventional in aerospace, has helped build trust with stakeholders and employees.</p>	<p>As Intel transitioned to non-technical CEOs, a profound authenticity gap emerged between leadership and the company's core identity as an innovation-driven organization. This mirrors Graham's observation about the limitations of professional managers who lack deep connection to their company's fundamental value creation. The leadership's disconnect from Intel's technical roots manifested in:</p> <ul style="list-style-type: none"> • Decisions being driven by financial metrics rather than technological advancement • Communication becoming increasingly opaque about technical challenges • Growing cultural divide between management and engineering teams
Commitment Beyond Self	<p>Perhaps most notably, Musk exemplifies commitment to something greater than oneself through SpaceX's mission to make humanity multiplanetary. This audacious goal transcends traditional business objectives. This commitment is demonstrated through:</p> <ul style="list-style-type: none"> • Investing nearly all his PayPal proceeds into SpaceX when failure seemed likely • Maintaining focus on Mars colonization despite pressure to pursue more profitable ventures • Consistently prioritizing long-term mission over short-term financial gains 	<p>Perhaps most critically, Intel lost sight of its commitment to something greater than quarterly profits. Moore's Law - the observation that the number of transistors on a microchip doubles approximately every two years while cost halves - had served not just as a technical roadmap but as an inspiring mission that gave meaning to the company's work.</p> <p>The shift away from this organizing principle:</p> <ul style="list-style-type: none"> • Fragmented the company's sense of purpose • Reduced employee motivation and engagement • Diminished Intel's role as an industry leader
Being Cause in the Matter	<p>Musk consistently takes full responsibility for SpaceX's outcomes, both successes and failures. Rather than blaming external factors or market conditions, he positions himself as ultimately responsible for the company's ability to achieve its mission.</p>	<p>Instead of taking full responsibility for outcomes and proactively shaping the industry's future, Intel's leadership began offering explanations and excuses for falling behind competitors. The company's reactive posture manifested in:</p> <ul style="list-style-type: none"> • Blaming external factors for competitive losses • Focusing on financial engineering over technical innovation • Failing to anticipate and lead industry transitions

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